Division of Local Services

Commonwealth of
Massachusetts
Department of Revenue

Everything You Always Wanted to Know About **Levy Limits**...But Were Afraid to Ask

A Primer on Proposition 2½

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Commissioner
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CONTENTS

PREFACE

The Division of Local Services has developed this primer to guide local officials through the mechanics of Proposition 2½. Proposition 2½ revolutionized property tax administration and is a fundamental feature of the municipal fiscal landscape, yet there is still confusion about its meaning for cities and towns, particularly because the law is complex and has undergone a number of changes since it was enacted in 1980.

The purpose of this primer is to explain, as simply as possible, the basic provisions of Proposition 2½. We focus in particular on those aspects of the law that we have found to cause the most confusion, for example: the ways in which Proposition 2½ limits the property tax, how the levy limit is calculated, how an override differs from a debt exclusion or capital outlay expenditure exclusion, and how new growth works.

With the help of this primer, a local official should be able to understand the fundamentals of Proposition 2½. However, this primer is not intended as a substitute for legal guidance on a community's options and obligations under the law. If you have any questions, please refer to the Appendix included in this primer and contact the Division of Local Services for additional assistance and information. The Appendix provides a list of Division of Local Services resources that address these issues, with instructions for obtaining copies, as well as a list of contact people within the Division who can assist you with any questions that you may have.

We hope that this primer will help you to grasp the basic concepts of Proposition 2½ and to act on behalf of your community with a better understanding of the law. We welcome your questions and comments on this publication.

1. WHAT IS A LEVY ?

The property tax levy is the revenue a community can raise through real and personal property taxes. We will refer to the property tax levy simply as the **levy.** In Massachusetts, municipal revenues to support local spending for schools, public safety, and other public services are raised through the property tax levy, state aid, local receipts and other sources. The property tax levy is the largest source of revenue for most cities and towns.

2. WHAT IS A LEVY CEILING? WHAT IS A LEVY LIMIT?

Proposition 2½ places constraints on the amount of the levy raised by a city or town and on how much the levy can be increased from year to year by a city or town.

A levy limit is a restriction on the amount of property taxes a community can levy. Proposition 2½ established two types of levy limit:

First, a community cannot levy more than 2.5% of the total full and fair cash value of all taxable real and personal property in the community. To avoid confusion, in this primer we will refer to the full and fair cash value limit as the **levy ceiling.**

Second, a community's levy is also constrained in that it can only increase by a certain amount from year to year. We will refer to the maximum amount a community can levy in a given year as the **levy limit.** The levy limit will always be below, or at most, equal to the levy ceiling. The levy limit may not exceed the levy ceiling.

Proposition 2½ does provide communities with some flexibility, however, in that it is possible, with voter approval, for a community to levy above its levy limit or its levy ceiling on a temporary basis, as well as to increase its levy limit on a permanent basis. This is discussed in more detail in other sections of this primer.

The concepts of levy ceiling and levy limit are illustrated in *figure 1.*

3. HOW IS A LEVY CEILING CALCULATED?

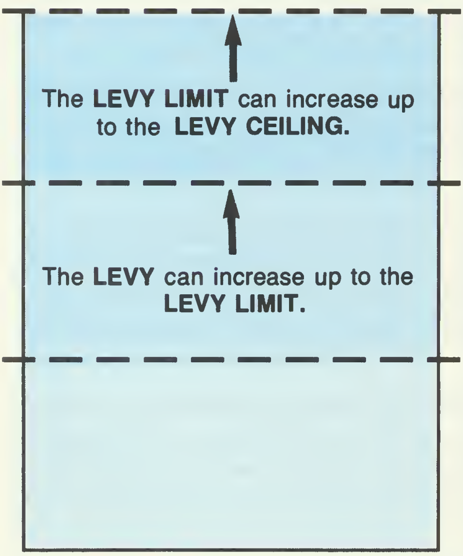
The levy ceiling is determined by calculating 2.5% of the total full and fair cash value of taxable real and personal property in the community:

FULL AND FAIR CASH VALUE × 2.5% = LEVY CEILING

FULL AND FAIR CASH VALUE = $100,000,000

$100,000,000 × 2.5% = $2,500,000

In this example, the levy ceiling is $2,500,000.



LEVY CEILING: The maximum the levy limit can be. The ceiling equals 2.5% of the community's full and fair cash value.

LEVY LIMIT: The maximum the levy can be in a given year. The limit is based on the previous year's limit plus certain allowable increases.

LEVY: The amount the community can raise through the property tax. The levy can be any amount up to the levy limit.

FIG. (1)

4. HOW IS A LEVY CEILING INCREASED?

When a community revalues its property, as it is required by law to do every three years, the total full and fair cash value increases. This raises the levy ceiling. With the rapid appreciation of property in Massachusetts in recent years, levy ceilings, in general, have risen substantially.

See figure 2.

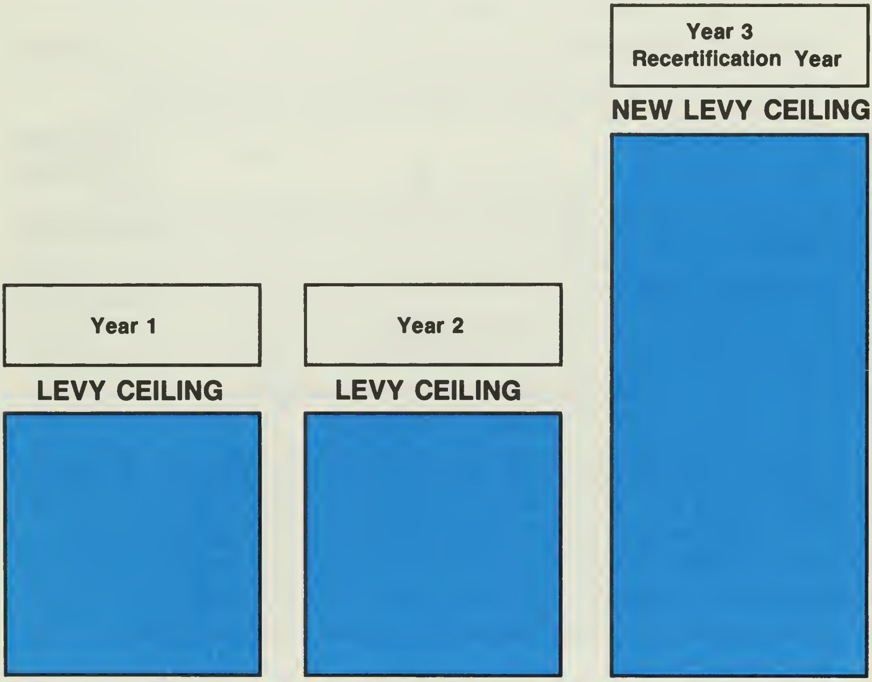


FIG. (2)

5. HOW IS A LEVY LIMIT CALCULATED?

Since 1981, when Proposition 2½ went into effect, a levy limit for each community has been calculated annually by the Department of Revenue. It is important to note that a community's levy limit is based on the previous year's levy limit and not the previous year's actual levy.

Each step in the example below is explained in more detail in other sections of this primer. A levy limit is calculated by:

Taking the previous year's levy limit and increasing it by 2.5%:

A. FY86 LEVY LIMIT		**$1,000,000**
B. (A) × 2.5%	+	**$25,000**

Adding to the levy limit amounts of certified new growth added to the community's property tax base:

C. FY87 NEW GROWTH	+	**$15,000**

Adding to the levy limit amounts authorized by override votes:

D. FY87 OVERRIDE	+	**$100,000**
E. FY87 SUBTOTAL (A + B + C + D)	=	**$1,140,000**

Comparing the FY87 levy limit to the FY87 levy ceiling and applying the lesser number (compare E and F):

F. FY87 LEVY CEILING	**$2,500,000**

$1,140,000

APPLICABLE FY87 LEVY LIMIT
(Lesser of E and F)

This community's levy limit, the maximum amount in real and personal property taxes it can levy, is $1,140,000 for FY87. How much of this amount the community actually wants to use — that is, the amount of the levy — is up to the discretion of local officials. *The community can levy up to or at any level below the entire levy limit amount, regardless of what its levy was in the previous year.* Levy Increases are discussed in *Section 11.*

6. HOW IS A LEVY LIMIT INCREASED?

The levy limit is increased from year to year as long as it remains below the levy ceiling. Permanent increases in the levy limit result from the following:

Automatic 2.5% increase. Each year, a community's levy limit automatically increases by 2.5% over the previous year's levy limit. This does not require any action on the part of local officials; the Department of Revenue calculates this increase automatically.

Growth Resulting from New Construction. A community is able to increase its levy limit each year to reflect growth in the tax base resulting from certain new construction and parcel subdivisions. Assessors are required to submit information on growth in the tax base for approval by the Department of Revenue as part of the tax rate setting process. New Growth is discussed in *Section 8.*

Overrides. A community can permanently increase its levy limit by successfully voting an override. The amount of the override becomes a permanent part of the levy limit base. Overrides are discussed in *Section 9.*

Please note that debt exclusions, capital outlay expenditure exclusions, and overrides are all often referred to as "overrides," as all require voter approval and enable a community either to permanently increase its levy limit or temporarily levy above its levy limit or levy ceiling. This primer makes a distinction between an override and a debt or capital outlay expenditure exclusion because there is a significant difference in the impact of each on a community's levy limit. An override enables a community to *permanently* increase its levy limit, while an exclusion only allows for a *temporary* increase in taxes over a community's levy limit. Overrides, debt exclusions, and capital outlay expenditure exclusions are discussed in greater detail in other sections of this primer.

In summary, the levy limit can increase from year to year in these ways: automatic 2.5% increase, new growth, and overrides. Once the levy limit is increased through any of these ways, the increased levy limit amount becomes the base upon which levy limits are calculated for future years. *See figure 3.*

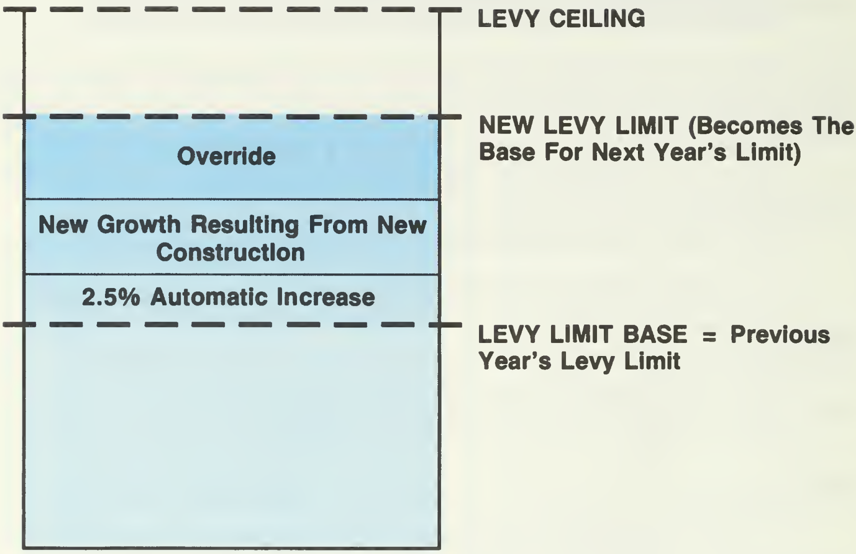


FIG. (3)

7. HOW CAN A COMMUNITY LEVY TAXES IN EXCESS OF ITS LEVY LIMIT OR ITS LEVY CEILING ?

A community can only levy taxes in excess of its levy limit or its levy ceiling through the following:

> **Debt Exclusions and Capital Outlay Expenditure Exclusions.** A community can assess taxes in excess of its levy limit or levy ceiling by successfully voting a debt exclusion or capital outlay expenditure exclusion. The amount of the exclusion does not become a permanent part of the levy limit base, but allows a community to assess taxes for a certain period of time in excess of its levy limit or levy ceiling for the payment of certain debt service costs or for the payment of certain capital outlay expenditures.

See figure 4.

In *figure 4(a)* the debt exclusion or capital outlay expenditure exclusion gives the community temporary additional taxing capacity over and above its levy limit, but below its levy ceiling.

In *figure 4(b)* the debt exclusion or capital outlay expenditure exclusion gives the community temporary additional taxing capacity that is over and above not only its levy limit, but also its levy ceiling.

For more information on Debt Exclusions and Capital Outlay Expenditure Exclusions see *Section 10.*

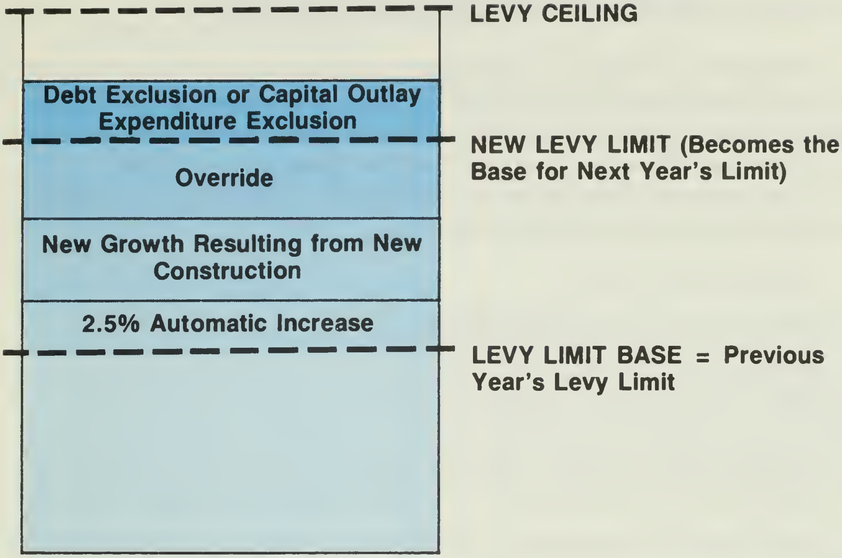
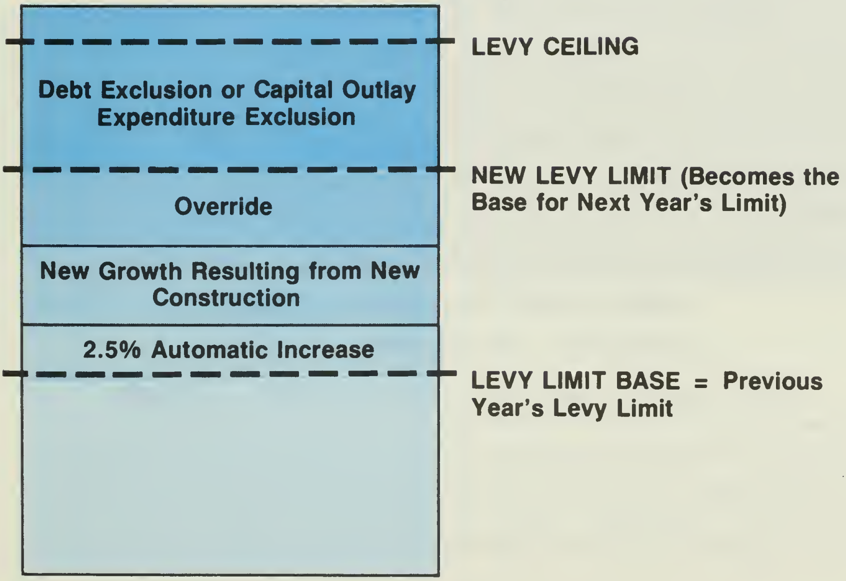

LEVY CEILING
Debt Exclusion or Capital Outlay Expenditure Exclusion
NEW LEVY LIMIT (Becomes the Base for Next Year's Limit)
Override
New Growth Resulting from New Construction
2.5% Automatic Increase
LEVY LIMIT BASE = Previous Year's Levy Limit

FIG. (4a)


LEVY CEILING
Debt Exclusion or Capital Outlay Expenditure Exclusion
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Override
New Growth Resulting from New Construction
2.5% Automatic Increase
LEVY LIMIT BASE = Previous Year's Levy Limit

FIG. (4b)

8. WHAT IS NEW GROWTH?

Proposition 2½ allows a community to increase its levy limit annually by an amount based upon the valuation of certain new construction and other growth in the tax base that is not the result of property revaluation. The purpose of this provision is to recognize that new development results in additional municipal costs; for instance, the construction of a new housing development may result in increased school enrollment, public safety costs, and so on.

This provision covers:

- new construction, additions, and alterations that result in increases in assessed valuation of 50% or more for Residential and Open Space property and increases in assessed valuation of at least $100,000 or 50% for Commercial, Industrial, and Personal property;
- exempt property returned to the tax roll and net increases in valuation for subdivision parcels and condominium conversions.

New growth is calculated by multiplying the increases in the assessed valuation of newly constructed or altered property, exempt property returned to the tax roll, and subdivision parcels and condominium conversions by the prior year's tax rate for the appropriate class of property.

Below we highlight how new growth is calculated:

INCREASES IN QUALIFYING ASSESSED VALUATION

× PRIOR YEAR'S TAX RATE FOR PARTICULAR CLASS OF PROPERTY

= NEW GROWTH ADDITION TO LEVY LIMIT

For example, for a community that applies the same tax rate to all classes of property:

INCREASES IN ASSESSED VALUATION = $1,000,000

PRIOR YEAR'S TAX RATE = $15.00

$1,000,000 × ($15.00/1000) = $15,000

NEW GROWTH ADDITION TO LEVY LIMIT = $15,000

Below we highlight where the addition of new growth occurs in the calculation of the levy limit:

Taking the previous year's levy limit and increasing it by 2.5%:

A. FY86 LEVY LIMIT		**$1,000,000**
B. (A) × 2.5%	+	**$25,000**

Adding to the levy limit amounts of certified new growth added to the community's property tax base:

C. FY87 NEW GROWTH	+	**$15,000**

Adding to the levy limit amounts authorized by override votes:

D. FY87 OVERRIDE	+	**$100,000**
E. FY87 SUBTOTAL (A + B + C + D)	=	**$1,140,000**

Comparing the FY87 levy limit to the FY87 levy ceiling and applying the lesser number (compare E and F):

F. FY87 LEVY CEILING	**$2,500,000**

$1,140,000

APPLICABLE FY87 LEVY LIMIT
(Lesser of E and F)

New growth becomes part of the levy limit base, and thus increases at the rate of 2.5% each year as the levy limit increases. Reporting of new growth provides a community with an opportunity to increase its levy limit, which can provide for added budget flexibility in the future. Beginning in FY88, Boards of Assessors are required to report new growth as a part of setting the tax rate.

9. WHAT IS AN OVERRIDE?

Proposition 2½ allows a community to assess taxes in excess of the automatic annual 2.5% increase and any increase due to new growth by passing an **override.** A community may take this action as long as it is below its levy ceiling, or 2.5% of full and fair cash value. An override cannot increase a community's levy limit above the level of the community's levy ceiling.

When an override is passed, the levy limit for the year is calculated by including the amount of the override. The override results in a permanent increase in the levy limit of a community, which as part of the levy limit base increases along with the base at the rate of 2.5% each year.

A majority vote of a community's Selectmen, or Town or City Council, with the Mayor's approval if required by law, allows an override question to be placed on the ballot. Override questions must be presented in dollar terms and must specify the purpose of the override. Overrides require a majority vote of approval.

Originally, Proposition 2½ provided for two different types of overrides, which required either a majority or a two-thirds vote of approval, based on the dollar amount of the override. In July 1987, the Legislature amended this provision to require a majority vote of approval for all overrides. The amendment also changed the vote required by the community's Selectmen, or Town or City Council, with the Mayor's approval if required by law, from a two-thirds to a majority vote. In addition, the amendment requires that an override ballot question state the purpose of the override.

Below we highlight where the amount of an override is added in the calculation of the levy limit:

Taking the previous year's levy limit and increasing it by 2.5%:

A. FY86 LEVY LIMIT		**$1,000,000**
B. (A) × 2.5%	+	**$25,000**

Adding to the levy limit amounts of certified new growth added to the community's property tax base:

C. FY87 NEW GROWTH	+	**$15,000**

Adding to the levy limit amounts authorized by override votes:

D. FY87 OVERRIDE	+	**$100,000**
E. FY87 SUBTOTAL (A + B + C + D)	=	**$1,140,000**

Comparing the FY87 levy limit to the FY87 levy ceiling and applying the lesser number (compare E and F):

F. FY87 LEVY CEILING	**$2,500,000**

$1,140,000

APPLICABLE FY87 LEVY LIMIT
(Lesser of E and F)

This community can levy up to its levy limit of $1,140,000 in FY87.

10. WHAT IS A DEBT EXCLUSION? WHAT IS A CAPITAL OUTLAY EXPENDITURE EXCLUSION?

Proposition 2½ allows communities to raise funds for certain purposes above the amount of their levy limits or levy ceilings. Subject to voter approval, a community can assess taxes in excess of its levy limit or levy ceiling for the payment of certain capital projects and for the payment of specified debt service costs. An exclusion for the purpose of raising funds for debt service costs is referred to as a **debt exclusion** and an exclusion for the purpose of raising funds for capital project costs is referred to as a **capital outlay expenditure exclusion.**

The additional amount for the payment of debt service is added to the levy limit or levy ceiling *for the life of the debt only.* The additional amount for the payment of the capital project cost is added to the levy limit or levy ceiling *only for the year in which the project is being undertaken.* Unlike overrides, exclusions *do not* become part of the base upon which the levy limit is calculated for future years.

For debt exclusions, reimbursements such as state reimbursements for school building construction are subtracted from the amount of the exclusion.

A capital outlay expenditure exclusion or debt exclusion is effective even in the rare case that the exclusion would bring the community's levy above its levy ceiling.

Both of these exclusions require a two-thirds vote of the community's Selectmen, or Town or City Council, with the Mayor's approval if required by law, in order to be presented to the voters. A majority vote of approval is required for both types of exclusion.

A single question may be presented to exclude *all* debt incurred prior to the enactment of Proposition 2½. A separate question must be presented to exclude the total amount of each Post-Proposition 2½ debt obligation, and must state the purpose or purposes for which the monies from the local issue will be used. A separate question must be presented for each capital outlay expenditure to be excluded and must state the purpose for which the monies from the exclusion will be used.

Below we highlight how exclusions are added to the levy limit:

Taking the previous year's levy limit and increasing it by 2.5%:

A. FY86 LEVY LIMIT		**$1,000,000**
B. (A) × 2.5%	+	**$25,000**

Adding to the levy limit amounts of certified new growth added to the community's property tax base:

C. FY87 NEW GROWTH	+	**$15,000**

Adding to the levy limit amounts authorized by override votes:

D. FY87 OVERRIDE	+	**$100,000**
E. FY87 SUBTOTAL (A + B + C + D)	=	**$1,140,000**

Comparing the FY87 levy limit to the FY87 levy ceiling and applying the lesser number (compare E and F):

F. FY87 LEVY CEILING		**$2,500,000**

$1,140,000

APPLICABLE FY87 LEVY LIMIT
(Lesser of E and F)

Calculating FY87 levy limit with debt exclusion or capital outlay expenditure exclusion:

H. FY87 LEVY LIMIT		**$1,140,000**
I. ADD FY87 DEBT EXCLUSION OR CAPITAL OUTLAY EXPENDITURE EXCLUSION	+	**$50,000**

$1,190,000

APPLICABLE FY87 LEVY LIMIT WITH DEBT EXCLUSION OR CAPITAL OUTLAY EXPENDITURE EXCLUSION

In FY87, this community can levy up to $1,190,000, its applicable levy limit with this debt exclusion or capital outlay expenditure exclusion.

11. LEVY INCREASES

Once a community's levy limit is established for a particular year, the community can determine what its levy will be. The community may set its levy at any amount up to the levy limit. (Or, if it has voted a debt exclusion or capital outlay expenditure exclusion, it may levy up to the levy limit *plus* the additional temporary capacity resulting from the exclusion.)

It is important to note that as long as a community levies no more than its levy limit, there is no restriction on the dollar increase or percentage increase in its levy from year to year. Proposition 2½ restricts increases in the *levy limit,* not the levy. A community is permitted to tax up to its levy limit, even if, to do so, it must raise its levy by a large percentage over the previous year's levy.

For example, a community could decide to increase its levy between FY86 and FY87 because the people of the community feel that the town should respond to some unmet local needs. Below are highlighted this community's FY86 and FY87 levy limits and levies:

FY86 LEVY LIMIT = $1,000,000
FY86 LEVY = $900,000

FY87 LEVY LIMIT = $1,025,000
FY87 LEVY = $1,025,000

PERCENTAGE CHANGE IN LEVY LIMIT = 2.5%
PERCENTAGE CHANGE IN LEVY = 13.8%

From FY86 to FY87, the community's levy limit only increases by the allowed 2.5% (assume the community has no new growth and has not voted an override). The community's levy increases from the FY86 amount of $900,000 up to its FY87 levy limit of $1,025,000. This is a total dollar increase in the actual levy of $125,000 — and a percentage increase in the actual levy of 13.8%. From FY86 to FY87, the actual levy increases by 13.8% while the levy limit only increases by the allowed 2.5%.

It is important to note that the 13.8% increase described here is allowable under the provisions of Proposition 2½. As long as the *levy limit* only increases each year by the amount allowed under Proposition 2½, the actual levy can increase or decrease within the levy limit established each year, as decided by the community. The community may increase its levy up to its new levy limit regardless of the percentage increase in the levy. This concept is illustrated in *figure 5.*

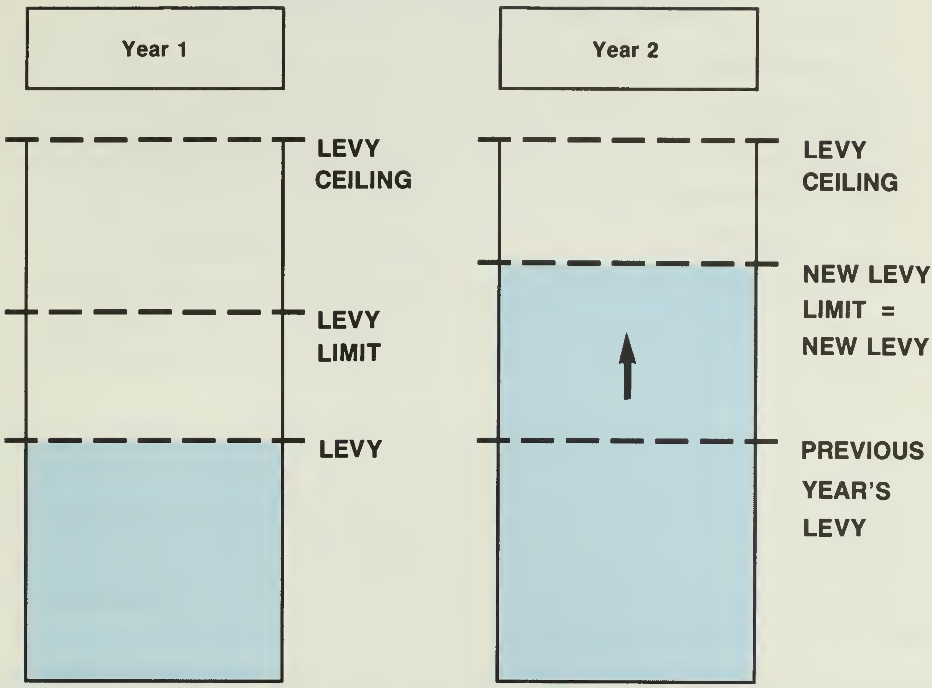

FIG. (5)

In Year 1, the community levies well below its levy limit.

In Year 2, the community's levy limit increases by the amount permitted under Proposition 2½. The community decides to levy all the way up to its new levy limit. The increase in the levy in Year 2 over Year 1 is indicated by the arrow. This increase is permissible under Proposition 2½.

12. EXCESS LEVY CAPACITY

As discussed in the previous section, a community may choose to set its levy at any amount below or equal to its levy limit. When a community sets its levy below the limit, the difference between the levy and the levy limit is commonly referred to as **excess levy capacity.** This is an additional amount the community could, but chose not to, levy.

LEVY LIMIT − LEVY = EXCESS LEVY CAPACITY

The concept of excess levy capacity is not a part of the Proposition 2½ law, as are the levy limit and levy ceiling. However, excess levy capacity has become an important factor in municipal finance, and local officials should understand this concept.

There are two common misconceptions about excess levy capacity. The first misconception is that if a community has excess levy capacity in one year, then its ability to levy up to its levy limit in succeeding years is negatively affected. This misconception is based on the fact that Proposition 2½ limits the amount a community can increase its property taxes from year to year. Many think that this means that a community cannot raise its levy all the way up to the levy limit to use all its excess capacity in just one year.

This is not true. As we have already seen, Proposition 2½ limits increases from year to year in the levy limit, not the levy. Before the tax rate is set, the full amount of the levy limit is always available to the community, REGARDLESS of how much of the limit the community has chosen to levy in previous years. It is within the law under Proposition 2½ for a community to have excess levy capacity in one year and, in the following year, to levy right up to the full amount of its new levy limit. This is true no matter what the percentage increase in the levy would be in order to achieve this result.

The second misconception about excess levy capacity is that a community is able to go back and "capture" excess levy capacity from a previous year. This is also not true. Once the community sets its tax rate for a given year, any revenues foregone because of excess levy capacity in that year are lost forever. This is only a one-time loss, however. In the following year, the community may levy up to its new levy limit, regardless of its levy in the previous year. See the example below:

FY86 LEVY LIMIT = $1,000,000
FY86 LEVY = $900,000
FY86 EXCESS LEVY CAPACITY = $100,000

FY87 LEVY LIMIT = $1,025,000
FY87 LEVY = $1,025,000
FY87 EXCESS LEVY CAPACITY = $0

INCREASE IN LEVY LIMIT = $25,000
INCREASE IN LEVY = $125,000

In FY86, the town levies only $900,000 of its levy limit of $1,000,000, foregoing $100,000 of tax revenue it could have collected. In FY87, the town's levy limit increases by the automatic 2.5% allowed by Proposition 2½, or up by $25,000 to $1,025,000. The town decides to levy all the way up to its new levy limit, so it has no excess capacity in FY87. Its FY87 levy is $125,000 higher than its FY86 levy. The town *cannot* also levy an additional amount to capture the $100,000 foregone in FY86. In other words, it cannot levy up to $1,125,000 for a total levy increase of $225,000. The $100,000 foregone in FY86 is lost forever. But this is a one-time loss, since the community *can*, in FY87, levy all the way up to its new levy limit. This is highlighted in *figure 6.*

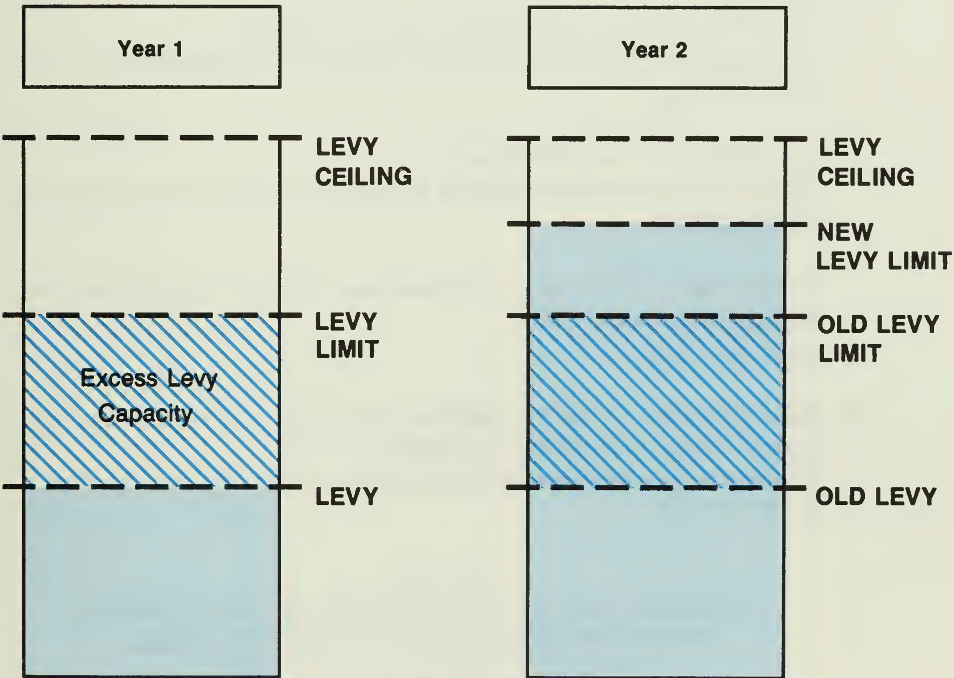

FIG. (6)

In Year 1, the community levies below its levy limit and as a result has excess levy capacity, represented by the area indicated.

In Year 2, the community may levy all the way up to its new levy limit. By levying up over its "old" levy limit (that is, its levy limit in Year 1), the community "uses" the excess capacity accrued in year 1, shown by the area indicated. The community may increase its levy up to the new levy limit regardless of the percentage increase in the levy that is required to do so.

However, in Year 2 the community may not go back and recover the actual dollars of excess levy capacity foregone in Year 1 (the area indicated in the Year 1 diagram). That tax revenue is lost forever. It is only a one-time loss, though, since the community can tax up to or above that level in Year 2.

APPENDIX

I. RESOURCES

- Informational Guideline Release (IGR) No. 87-404: Fiscal Year 1988 Guidelines for Adjustments to Tax Levy for Property Tax Base Growth

- Proposition 2½ Referenda Questions

II. CONTACTS

- *For information on Levy Limits and Levy Ceilings:*
  Tony Rassias, Bureau of Accounts, Division of Local Services
  (617) 727-2300

- *For information on New Growth:*
  Arthur Ecclestone, Bureau of Local Assessment, Division of Local Services
  (617) 727-2300

  Karen Avalle, Bureau of Local Assessment, Division of Local Services, Springfield Regional Office
  (413) 784-1000

- *For information on Ballot Questions (Overrides, Debt Exclusions, and Capital Outlay Expenditure Exclusions):*
  Kathleen Colleary, Property Tax Bureau, Division of Local Services
  (617) 727-2300

TO ORDER ANY OF THE RESOURCES LISTED ABOVE, COMPLETE AND MAIL THE FORM ATTACHED.

ORDER FORM

Please send me the following:

________ copies of IGR No. 87-404

________ copies of Proposition 2½ Referenda Questions

NAME: ____

TITLE: ____

STREET ADDRESS: ___________________________________

CITY/TOWN:__________________________ **ZIP CODE:** __________

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10M-706201-7/88

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